

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 7062

BILL NUMBER: SB 441

NOTE PREPARED: Feb 14, 2015

BILL AMENDED: Feb 12, 2015

SUBJECT: Eliminates Certain Tax Deductions and Credits.

FIRST AUTHOR: Sen. Hershman

FIRST SPONSOR:

BILL STATUS: CR Adopted - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) The bill contains the following provisions:

Property Tax - WWI Veteran Deduction: It eliminates the World War I veteran property tax deduction for property taxes imposed for an assessment date after 2015.

Property Tax - Enterprise Zone Investment Deduction: It eliminates the enterprise zone investment deduction for qualified investments made after May 1, 2016.

Sales Tax - Double Direct Test: It provides that the equipment eligible for the double direct Sales Tax exemption includes equipment purchased for the purpose of transporting materials into production activities from an onsite location.

Sales Tax - Timber Harvesting: It specifies that the double direct Sales Tax exemption applies to agricultural machinery, tools, and equipment that is acquired for timber harvesting.

Income Tax - Civil Service Annuity Deduction: It increases the maximum amount of the state income tax deduction for federal civil service annuity income to \$8,000 for 2015 and \$16,000 for 2016 and thereafter. It also provides that the deduction is also available to a surviving spouse.

Income Tax - Venture Capital Investment Credit (VCI): The bill extends the sunset date of the VCI tax credit from January 1, 2017, to January 1, 2021.

Income Tax - Hoosier Business Investment (HBI): The bill extends the sunset date of the HBI credit from

January 1, 2017, to January 1, 2021. It provides that upgrading or building passing lines or automated switches on a rail line is an eligible logistics investment for purposes of the HBI credit.

Income Tax - Adjustments, Deductions, and Credits: It eliminates various adjustments for purposes of determining Indiana adjusted gross income (AGI). It also eliminates various income tax deductions, exemptions and credits.

Business Income Definition: It provides that business income is all income apportionable to the state under the Constitution of the United States.

Interest Expense Adjustment: It broadens the add back to Indiana AGI related to intercompany interest expenses.

Tax Amnesty: It provides for a tax amnesty program.

The bill makes technical corrections and conforming amendments.

Effective Date: (Amended) January 1, 2015 (retroactive); July 1, 2015; January 1, 2016; January 1, 2017.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes made by the bill. With the exception of the required tax amnesty program, the DOR's current level of resources should be sufficient to implement these changes.

When the DOR conducted a tax amnesty program in 2006, the total cost was about \$15.5 M. That included contracting with an outside collections agency to assist with the project because the DOR did not have the capacity or resources to contact all potential amnesty cases. It is unknown whether the DOR currently has the resources to conduct this project without outside assistance. The bill does not appropriate funds for a tax amnesty project. The additional funds and resources required could be supplied through existing staff and resources currently being used in another program or with new appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend on legislative and administrative actions.

Explanation of State Revenues: (Revised) The table below summarizes the estimated impact of provisions in the bill. (Provisions having no fiscal impact are excluded from the table.) Following the table are brief explanations of the provisions and potential revenue impacts. The provisions are categorized based on whether they are: (1) likely to increase state revenue, (2) likely to have no fiscal impact, or (3) likely to decrease state revenue.

Provision	Estimated Impact (\$ in millions)		
	FY 2016	FY 2017	FY 2018
Sales Tax - Double Direct Test	(\$21.0 - \$35.0)	(\$50.0 - \$85.0)	(\$50.0 - \$85.0)
Sales Tax - Timber Harvesting	(\$0.8 - \$1.1)	(\$1.8 - \$2.7)	(\$1.8 - \$2.7)
Income Tax - Civil Service Annuity Deduction	(\$1.1)	(\$4.0)	(\$4.0)
Income Tax - Venture Capital Investment Credit	\$0	\$0	(\$4.3 - \$6.5)
Income Tax - Hoosier Business Investment Credit	\$0	*	(\$8.9)
Business Income	*	*	*
Intercompany Interest Expense Add Back	*	*	*
Tax Amnesty	\$0	\$109.0 - \$159.0	\$0
Income Tax - Eliminating Adjustments, Deductions, and Credits	\$0	\$6.0	\$5.8
Total	(\$22.9 - \$37.2)	\$59.2- \$73.3	(\$63.2 - \$101.3)

* Indeterminable fiscal impact.

Likely to Decrease State Revenue -

(Revised) *Sales Tax - Double Direct*: The bill expands the current sales tax exemption for items directly used in the direct production of tangible personal property to include equipment purchased for the purpose of transporting material into the production process from an onsite location. The revenue loss will begin in FY 2016 as businesses purchase exempt items in the first half of CY 2016, but the full revenue impact will begin in FY 2017. The estimated revenue loss associated with this provision may range from \$21.0 M to \$35.0 M in FY 2016 and \$50.0 M to \$85.0 M each fiscal year thereafter.

[Sales tax revenue is deposited in the state General Fund (98.848%), the Motor Vehicle Highway Account (1%), the Commuter Rail Service Fund (0.123%), and Industrial Rail Service Fund (0.029%).]

(Revised) *Sales Tax - Timber Harvesting*: Under current law, harvesters of timber do not qualify for the sales tax exemptions for agricultural machinery, tools, and equipment and other tangible personal property acquired for direct use in the direct production of agricultural commodities. By including timber harvesting in these exemptions, the bill could reduce sales tax revenue by approximately \$0.8 M to \$1.1 M in FY 2016 and \$1.8 M to \$2.7 M annually beginning in FY 2017.

(Revised) *Income Tax - Civil Service Annuity Deduction*: This bill increases the allowable deduction for federal civil service annuity pay from \$2,000 to \$8,000 for tax year 2015 and \$16,000 for each tax year thereafter. In addition, the bill allows surviving spouses to claim the deduction. Since this provision goes into effect in tax year 2015, the revenue loss would likely begin in FY 2016. The estimated revenue loss from changing the deduction could be about \$1.1 M in FY 2016 and \$4.0 M in FY 2017. The revenue loss could remain relatively flat or grow by as much as 3.0% annually thereafter due to growth in the federal retiree population and the cost-of-living adjustments for those retirees.

(Revised) *Income Tax - Venture Capital Investment Credit (VCI)*: The bill extends the credit's sunset provision, so the credit may be awarded for qualifying investments made before 2021. Current statute does not allow new credits to be awarded for investments made after 2016. The estimated state General Fund revenue loss associated with this provision ranges from \$4.3 M to \$6.5 M each year beginning in FY 2018.

(Revised) *Income Tax - Hoosier Business Investment Credit (HBI)*: This bill expands the definition of a qualifying logistics investment and allows the HBI credit to be awarded for qualifying investments until 2021. Current statute does not allow new credits to be awarded for investments made after 2016. The expanded logistics investment definition could impact credits awarded in FY 2017 while extending the sunset provision will impact revenue beginning in FY 2018. The estimated state General Fund revenue loss associated with this provision is indeterminable in FY 2017 and \$8.9 M each year beginning in FY 2018.

Likely to Increase State Revenue -

Business Income Taxation: The bill changes Indiana's definition of business income to all income that is apportionable to the state under the Constitution of the United States. This affects what income the taxpayer must apportion when computing Indiana source income. This will likely increase state revenue by an indeterminate amount particularly from gains on liquidating sales and certain unitary transactions. The revenue impact will likely begin in FY 2016 as corporations with liability periods ending in the first half of CY 2016 file their returns, but the full revenue impact will begin in FY 2017.

Intercompany Interest Expense Add Back: The bill clarifies the current law related to an add back of interest expense deduction taken on a corporation's federal income tax return for certain interest expenses paid, accrued, or incurred by the corporation with one or more members of the same "affiliated group" of corporations or with one or more foreign corporations. This provision could lead to an increase in compliance by taxpayers that disregard the current add back provision due to lack of clarity in the statute.

(Revised) *Income Tax - Adjustments, Deductions, and Credits*: This bill eliminates 17 income tax adjustments, deductions, and credits beginning after December 31, 2015. The net impact of eliminating these provisions could increase state General Fund revenue about \$6.0 M in FY 2017 and \$5.8 M each year thereafter. [Please see the table at the end of this document for a complete list of the provisions eliminated by the bill.]

Tax Amnesty: Under the bill, the DOR would adopt emergency rules to establish a tax amnesty program for listed taxes due and payable for a tax period ending before January 1, 2013. The program would not last more than eight weeks, and it would end before January 1, 2017. Using the average and median collection rates of similar programs, the proposed tax amnesty program could collect about \$109 M to \$159 M.

Additional Information -

(Revised) *Sales Tax - Double Direct*: The estimates were derived through an analysis of the capital flow information published by the U.S. Bureau of Economic Analysis (BEA) and Indiana commodity use data produced and published by IMPLAN Group LLC. The bill likely will affect the taxability of the following commodities used by agriculture, mining, and manufacturing industries: farm machinery, material handling equipment, light trucks, heavy duty trucks, trailers, and miscellaneous transportation equipment. The estimate assumes that an additional percentage of the impacted goods will be tax exempt because these goods are used in pre-production activities.

(Revised) *Sales Tax - Timber Harvesting*: The estimated revenue loss is based on current sales tax collections and an analysis of the commodity use input-output tables published by the BEA. The BEA's input data for the forestry industry sector is analyzed to determine which commodities would be used as an intermediate input into the production of other tangible goods or would be a final good used by the industry. The estimated revenue loss assumes that a share of each commodity identified as a production input would meet the current double direct test and be tax exempt under the bill. The assumed shares qualifying for the sales tax exemption are 90% and 95%.

(Revised) *Income Tax - Civil Service Annuity Deduction*: Data from the U.S. Office of Personnel Management indicates that there were about 20,165 Civil Service Retirement System (CSRS) retirees and about 6,774 surviving spouses of CSRS retirees residing in Indiana. The federal CSRS retirees received an estimated \$750.5 M in annuity payments and surviving spouses of CSRS retirees received an estimated \$118.7 M in annuity payments during 2014. The average payment to a federal CSRS retiree was about \$37,000, and the average for surviving spouses was about \$17,500. The total payments to retirees and their spouses in Indiana increased, on average, 3.75% annually over the past four years.

The estimate relating to civil service annuitants assumes those currently claiming the \$2,000 deduction (4,548 taxpayers) will be able to claim the additional deduction amounts. It also assumes that additional civil service annuitants, about 2,250 in 2015 and 9,400 in years thereafter, will be able to claim part or all of the additional deduction. The estimate relating to surviving spouses assumes that survivor's benefits and Social Security payments to these individuals are distributed similar to payments to civil service annuitants.

Tax Amnesty: Under the tax amnesty program, applicable interest, penalties, collection fees, and costs would be excused on liabilities voluntarily paid or for which a payment program acceptable to DOR is established. Also, DOR would not seek civil or criminal prosecution of the taxpayer or issue an assessment, warrant, or demand notice against the taxpayer. However, if the taxpayer fails to pay the tax liability eligible for payment under the program, the liability would be subject to a doubling of penalties imposed or otherwise due. An exception to the doubling of penalties would exist for certain taxpayers who: timely file an original tax appeal in the Tax Court; have a legitimate hold on making the payment; prove to the Commissioner that notice of the outstanding tax liability was never received; or have established a payment plan with DOR. Additionally, a taxpayer would enter into an agreement that the taxpayer would not be eligible for any future amnesty program for the same listed tax. DOR would be required to enforce the agreement.

Indiana conducted an amnesty program in 2006, and it yielded \$244 M in revenue. The table below contains the source of prior amnesty collections by tax type.

Tax Type	% of Amnesty Revenue
Corporate Income and Financial Institutions Tax	46%
Sales and Use Tax	25%
Individual Income Tax	24%
All other tax types	5%

The amnesty collection estimates are based on published research, the effectiveness of similar state amnesty programs, and the results of Indiana's prior amnesty program. The actual revenue from the proposed amnesty

program depends on the total qualified tax liabilities, the success of marketing the program, and the liabilities of the taxpayers who participate in the program.

Income Tax - Adjustments, Deductions, and Credits: The estimates are based on Indiana income tax return data, and estimates published by the Joint Committee on Taxation. Many of the adjustments are linked to expired federal tax provisions. Consequently, repealing these provisions would not impact AGI tax revenue unless: (1) the Congress enacts legislation to extend the provisions beyond tax year 2015; and (2) the reference in Indiana statute to the IRC in effect on a particular date is updated to include such legislation. However, Indiana taxpayers were able to adjust their AGI to account for depreciation on the costs they were not allowed to expense under Indiana code because it did not conform to certain provisions of the IRC. Eliminating those adjustments removes the mechanism for taxpayers to expense for those prior year costs. This only applies to adjustments for disaster assistance property, certain refinery property, film and television production costs, and the loss of certain preferred stocks treated as ordinary income. Also, it is assumed that some taxpayers will continue to carry forward unused credits. The bill does not prevent taxpayers from carrying forward unused credits if it was authorized by the specific credit statute.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) *Local Option Income Taxes (LOIT):* Eliminating state income tax adjustments and deductions and modifying the Civil Service Annuity Deduction will affect Indiana taxable income, so counties imposing local option income taxes (LOIT) could potentially experience a change in revenue. The bill also repeals the county income tax credit for the elderly or permanently disabled. LOIT collections on a statewide basis could be increased by an estimated \$1.8 M in FY 2016 and \$0.5 M annually beginning in FY 2017.

In 2012, the county income tax credit for the elderly or permanently disabled was claimed by 677 taxpayers and reduced statewide LOIT revenue by \$23,875.

Sales Tax: Local revenues could decrease to the extent that a local unit receives distributions from Sales Tax revenue.

WWI Veteran Deduction: Under current law, WWI veterans may receive an \$18,270 property tax deduction against their residence as long as the AV does not exceed \$206,500. It is believed that there are no living WWI veterans. Elimination of this deduction will have no impact.

Enterprise Zone Investment Deduction: The elimination of the enterprise zone investment deduction for qualified investments made after March 1, 2016, would cause the this deduction to be phased out over the next ten years.

Currently, a taxpayer may receive a property tax deduction within an enterprise zone for up to 10 years. The deduction equals the increase in AV over the base year for qualified investments in real and personal property. As the deductions for the current qualified investments phase out, there will be no new deductions to take their place. Taxes will shift back to the current qualified property, circuit breaker losses for local units will decrease, cumulative fund levies will increase, and overall TIF revenues will increase.

For taxes payable in 2014, there were 161 real property deductions totaling \$217.5 M. The tax benefit is about \$4.1 M. About \$500,000 in taxes are shifted to other taxpayers, \$600,000 is lost to circuit breaker caps, cumulative funds lose \$277,000, and TIF proceeds are reduced by \$2.7 M.

There were also 239 personal property deductions totaling \$271.7 M. The tax benefit is about \$5.0 M. About \$2.3 M in taxes are shifted to other taxpayers, \$2.5 M is lost to circuit breaker caps, cumulative funds lose \$785,000, and TIF proceeds are increased by \$600,000 M.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation; Indiana Housing and Community Development Authority; Indiana State Education Department; Indiana Commission for Higher Education; Ports of Indiana.

Local Agencies Affected: County auditors; Counties that impose a local option income tax.

Information Sources: LSA Income Tax database; Joint Committee on Taxation; Wolters Kluwer CCH, *2015 U.S. Master Tax Guide*, November 2014. *Tax Increase Prevention Act of 2014*, H.R. 5771, P.L. 113-295, 12/19/2014. Mengle, Rocky, *State Apportionment of Business Income*, Wolters Kluwer CCH White Paper, September 2014; LSA parcel-level property tax database; Indiana Department of State Revenue, *Indiana Tax Amnesty Final Report*, July 1, 2006; Federation of Tax Administrators, *State Amnesty Programs November 22, 1982 – Present*, September 14, 2014; Resnick, Phyllis, *The Effectiveness of Tax Amnesty Programs: 1982-2002*, Center for Tax Policy, 2002; U.S. Census, *State Government Tax Collections*; Bureau of Labor Statistics, *Quarterly Census of Employment and Wages*, 2013 Fourth Quarter, Private, All Industry; Indiana Department of State Revenue, *Tax Competitiveness and Simplification Report*, September 2014; Allied-Signal, Inc. v. Director, Division of Taxation, 504 US, 768 (1992), No. 91-615. COST, *Sales Taxation of Business Inputs*, 2005. Bureau of Economic Analysis (BEA); *Capital Flow Table*, 1997; IMPLAN, Indiana Study Area, 2012, Social Security Benefits, Beneficiary Data, <http://www.ssa.gov/OACT/ProgData/types.html>; OASDI, *OASDI Beneficiaries by State and County: Indiana*, http://www.ssa.gov/policy/docs/statcomps/oasdi_sc/index.html; Data on Federal Civil Service Annuitants in Indiana, U.S. Office of Personnel Management (OPM); FEDSCOPE: OPM Personnel Reporting Cube, <http://www.fedscope.opm.gov/>.

Fiscal Analyst: Heath Holloway, 232-9867; Bob Sigalow, 317-232-9859; Lauren Tanselle, 317-232-9586; Randhir Jha, 317-232-9556.

Impact of Income Tax Adjustments, Deductions, and Credits Eliminated By the Bill		
Tax Provision	FY 2017	FY 2018
Certain trade or business deductions based on employment of unauthorized alien adjustment	(\$3,000)	(\$3,000)
Discharge of debt of a principal residence adjustment	\$0	\$0
Federal economic stimulus payment of 2008 deduction	\$0	\$0
Individual development account credit	\$96,000	\$98,000
Insulation deduction	\$1,064,000	\$1,024,000
Law enforcement reward deduction	\$1,000	\$1,000
Lump sum distribution from qualified plans of participants born before January 2, 1936, adjustment	(\$132,000)	(\$129,000)
Maritime opportunity district qualifying export income deduction	\$0	\$0
Non-Indiana locality earning deduction	\$3,760,000	\$3,699,000
Partial Indiana lottery winnings deduction	\$560,000	\$530,000
Qualified disaster assistance property adjustment	\$33,000	\$31,000
Qualified film or television production adjustment	\$7,000	\$7,000
Qualified preferred stock (Fannie & Freddie losses) adjustment	(\$165,000)	(\$158,000)
Qualified refinery property adjustment	\$736,000	\$706,000
Solar roof vent fan deduction	\$7,000	\$8,000
Tax credit for computer donations to certain educational facilities	\$0	\$0
Unemployment compensation payment in 2009 adjustment	\$0	\$0
Total	\$5,964,000	\$5,814,000